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IN THE
Supreme Court of the United States

October Term, 1978

LIBERTY LIFE INSURANCE COMPANY,
PETITIONER

v.

UNITED STATES OF AMERICA,
RESPONDENT

On Petition For A Writ of Certiorari To The United States Court of Appeals For The Fourth Circuit

REPLY BY PETITIONER

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REPLY BY PETITIONER

Liberty Life Insurance Company submits this reply to the brief of the United States in opposition to its petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case. In replying to respondent's arguments, petitioner relies on its petition which fully discusses its position with respect to the license fee and discount questions.

I. LICENSE FEE QUESTION

Respondent's entire case, as presented in its brief, rests on labeling the license fee as a premium tax. Once so labeled, respondent then contends (Res. Br., pp. 7-8) that it has always been established that state premium taxes are not deductible as investment expenses. As pointed out previously by petitioner (Pet., p. 12), South Carolina law does not call the tax a premium tax, petitioner does not record it on its Annual Statement as a premium tax, and the tax does not function in petitioner's case as a premium tax. South Carolina law designates the tax a license fee and it functions in petitioner's case as

an income tax. There are no provisions in the Internal Revenue Code or the Regulations which prevent an allocation of license fees or state income taxes as investment expenses where, as in petitioner's case, there is a basis for allocation such as an increase attributable directly to investment income. Accordingly, regardless of the name given to this tax, a portion of it is deductible as an investment expense since it results directly from the earning of investment income.

While the license fee does not function as a premium tax, respondent has not shown that there is any case law, statute, ruling, or regulation which would prevent an allocation of a premium tax as an investment expense where there is a basis for allocation such as an increase attributable directly to investment income. Respondent's sole justification for its position is a comment made over fifty years ago by a Treasury Department witness, Dr. T. S. Adams, in connection with deliberations on the 1921 Act, which has long since been repealed.

It should be noted that respondent did not quarrel with petitioner's comparison of the license fee to the profit-sharing allocation issue in *Liberty National Life Insurance Company v. United States*, 39 AFTR 2d 77-540 (D.C. Ala.), rev'd, No. 77-1578 (5 Cir. August 13, 1979; petition for rehearing pending). Although the Fifth Circuit did not reach the profit-sharing issue in its decision, the holding of the Fourth Circuit on the license fee is contrary in theory to the holding of the District Court in *Liberty National* on the profit-sharing issue (See Pet., pp. 8-9).

For the reasons stated above and in the petition, the decision on the license fee presents an important question of federal tax law which should be decided by the Supreme Court of the United States. Significantly, respondent does not disagree that the license fee is an important question of federal tax law. Accordingly, the petition for a writ of certiorari on the license fee question should be granted.

II. DISCOUNT QUESTION

Since filing the petition for a writ of certiorari in this case, the Fifth Circuit Court of Appeals has reversed the decision in the *Liberty National* case with respect to the discount issue.

Liberty National Life Insurance Company v. United States, 39 AFTR 2d 77-540 (D.C. Ala.), rev'd, No. 77-1578 (5 Cir. August 13, 1979; petition for rehearing pending). Although both the Fourth and Fifth Circuits have ruled against the insurance company on the discount question, there nevertheless exists an important conflict between the Circuits on one of the major points in the case, namely, whether or not the discount can be partitioned between interest and expense.

Near the end of its decision in the *Liberty National* case, the Fifth Circuit stated as follows:

> We recognize that some part of the discount may be attributable to interest. In fact, the government admitted this at trial. Thus, it could be argued that the portion of the discount that is in the nature of interest is properly deductible. *Contra, Liberty Life Ins. Co. v. United States*, 594 F. 2d 21, 28 (4 Cir. 1979), *petition for cert. filed*, 47 U.S.L.W. 3814 (U.S. June 19, 1979) (No. 78-1825). This was not Liberty National's argument, however. At all stages of this proceeding it has argued that the discount was entirely and solely interest. Taxpayer refused to argue that the discount could be partitioned even after the possibility was discussed at oral argument before this panel.

It can be seen that the Fourth and Fifth Circuits disagree on whether a portion of the discount is in the nature of interest. The Fifth Circuit apparently felt that a portion was in the nature of interest, but the insurance company did not argue this point. In contrast, petitioner in this case did take the position in its appellate brief and at oral argument that the discount could be partitioned, but the Fourth Circuit did not agree. Interestingly enough, in both cases the government admitted that the discount included interest and the Courts held that a portion of the discount was interest. It would seem, therefore, that the proper and just decision in both cases is to allow a portion of the discount as interest paid.

There is also a conflict between the Circuits on whether

the ultimate issue is a question of law or a question of fact. The Fifth Circuit held that it was a question of law, but the Fourth Circuit viewed the discount as one of fact and held that petitioner had to show that the findings of the District Court were clearly erroneous. It would seem that since the discount includes interest, as a matter of law the portion of the discount which is allocable to interest should be allowed under Phase One. This argument by petitioner was ignored by the Fourth Circuit.

Respondent did not disagree with petitioner's position that its accounting treatment of the discount was entitled to great weight in light of the Supreme Court's decision in *Standard Life and Accident Insurance Company v. Commissioner*, 433 U.S. 148 (1977), and Section 818(a) of the Internal Revenue Code of 1954.

Accordingly, because of the conflict between the Circuits on whether or not the discount can be partitioned, and because of the importance of this question of federal tax law, it is respectfully submitted that the petition for a writ of certiorari on the discount question should be granted in order that this conflict may be resolved by the Supreme Court of the United States.

CONCLUSION

The petition for a writ of certiorari should be granted on both the license fee and discount questions.

Respectfully submitted,

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September, 1979